

Date Mailed  
August 26, 2002

BEFORE THE  
PUBLIC SERVICE COMMISSION OF WISCONSIN

Accounting Treatment for Patronage Capital by  
Telecommunications Cooperatives

05-US-115

**NOTICE OF INVESTIGATION**

Initial Comments Due: <b>Tuesday, October 1, 2002 – Noon</b>	Address Comments To: <b>Lynda L. Dorr</b> <b>Secretary to the Commission</b> Public Service Commission of Wisconsin P.O. Box 7854 Madison, WI 53707-7854
Initial Comments Fax Due: <b>Monday, September 30, 2002 – Noon</b>	
Reply Comments Due: <b>Friday, October 11, 2002 – Noon</b>	
Reply Comments Fax Due: <b>Thursday, October 10, 2002 – Noon</b>	

**THIS IS AN INVESTIGATION** to determine the appropriate accounting treatment for patronage capital by incumbent local exchange carrier (ILEC) telecommunications cooperatives,<sup>1</sup> including whether changes should be made to the Uniform System of Accounts (USOA) for Class A and Class B telephone utilities to adopt two new subaccounts 4550.1, Retained Earnings-Patronage Capital Unassigned, and 4550.2, Retained Earnings-Patronage Capital Assigned, and to create a new account 4511, Members Equity, and, if so, the effective date of any such changes.<sup>2</sup> This investigation is conducted pursuant to Wis. Stat. §§ 196.02(1), 196.06, and other provisions of Wis. Stat. ch. 196 as may be pertinent hereto.

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<sup>1</sup> There are 11 cooperatives in Wisconsin: Chequamegon Telephone Cooperative, Inc.; Chibardun Telephone Cooperative, Inc.; Citizens Telephone Cooperative, Inc.; Cochrane Cooperative Telephone Company; LaValle Telephone Cooperative; Marquette-Adams Telephone Cooperative, Inc.; Nelson Telephone Cooperative; Richland-Grant Telephone Cooperative, Inc.; Tri-County Telephone Cooperative, Inc.; Vernon Telephone Cooperative, Inc.; and West Wisconsin Telcom Cooperative, Inc.

<sup>2</sup> A companion investigation, docket 05-US-113, *In the Matter of Prescribing a Uniform System of Accounts for Class A and Class B Telephone Utilities*, is examining possible changes to the USOA which could be effective January 1, 2003, to coincide with changes adopted by the Federal Communications Commission. At its open meeting on August 15, 2002, the Commission determined that the issue concerning accounting for cooperative's patronage capital should be addressed outside of docket 05-US-113; Chairperson Ave Bie dissented with respect to revisiting the patronage capital issue. The Commission has issued a Notice of Investigation dated August 19, 2002, in docket 05-US-113.

By order dated October 1, 1987, in docket 05-US-102, the Commission adopted and prescribed, with certain amendments, the USOA, as set forth in Federal Communications Commission (FCC) docket 78-196, for use by the Class A and Class B telephone companies, including ILEC telecommunications cooperatives, under its jurisdiction. This Commission, by supplemental orders in docket 05-US-102 dated May 2, 1989, February 6, 1990, June 17, 1993, July 15, 1994, October 31, 1995, December 22, 1997, and March 24, 1999, prescribed amendments to this system of accounts.

One of the issues addressed by the Commission in the Chibardun Order<sup>3</sup> was the treatment of patronage capital; specifically whether it was part of retained earnings. The order contains extensive discussion concerning the patronage capital of Chibardun Telephone Cooperative, Inc. (Chibardun), in the section labeled “The Status of Patronage Capital” on pp. 20-22.

In the Chibardun Order, the Commission stated (p. 11; Finding of Fact ¶ 12):

12. To properly account to the Commission for patronage capital, patronage capital should be included in account 4520 of the Uniform System of Accounts (as adopted by the Commission) as “additional paid in capital.”

In addition, the Commission stated on p. 13 in Conclusion of Law ¶ 5:

5. Chibardun’s patronage capital is not part of retained earnings, within the meaning of Wis. Stat. § 196.204(1).

As a follow-up to the Chibardun Order, Commission staff issued a letter on December 17, 2001, to the 11 ILEC telecommunications cooperatives in the state (including Chibardun) that addressed accounting treatment for patronage capital by cooperatives. Staff’s letter requested that, consistent with the Commission’s finding in docket 1090-TI-100, each cooperative reclassify its patronage capital to account 4520, Additional Paid-in Capital, by December 31, 2001, and reflect such classification in its 2001 ILEC annual report to be filed with the Commission. That letter requested each cooperative to confirm in writing that this change was being made or, in the alternative, to inform the Commission of the “particulars constituting alternate classification.”

On April 3, 2002, the last of the 11 responses from the cooperatives was received. The responses were very uniform. Each response basically indicated the following:

1. The cooperative disagrees with the staff conclusion concerning the USOA;
2. Patronage capital does not qualify for inclusion in account 4520, Additional Paid-in Capital;

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<sup>3</sup> *Investigation of Possible Improper Subsidization by Chibardun Telephone Cooperative, Inc., of its Subsidiaries and of Possible Related Violations*, Docket 1090-TI-100 (November 16, 2001) (Chibardun Order).

3. The cooperative intends to use the following in closing the books for calendar year 2001. The cooperative will use two separate subaccounts (4550.1, Retained Earnings - Patronage Capital Unassigned, and 4550.2, Retained Earnings - Patronage Capital Assigned) to record undistributed amounts derived from operations of the cooperative;
4. The cooperative requests a new account 4511, Members Equity; and
5. The cooperative requests that the Commission issue an accounting order in docket 05-US-102, adopting the 4550.1 and 4550.2 subaccounts and a new 4511 account for cooperatives effective December 31, 1988.<sup>4</sup>

In addition, Citizens Telephone Cooperative, Inc.; Marquette-Adams Telephone Cooperative, Inc.; Nelson Telephone Cooperative (Nelson); and West Wisconsin Telcom Cooperative, Inc., further posited that the federal Rural Utilities Service (RUS), the Rural Telephone Finance Cooperative (RTFC), and other financial institutions that lend money to cooperatives recognize patronage capital the same as retained earnings to measure financial strength. These cooperatives stated that, historically, patronage capital has been presented as earnings retained in the cooperative, and that the cooperative determines when assigned and unassigned patronage capital is returned to members in the same manner as when a corporation determines when dividends are declared and paid.

The Wisconsin Federation of Cooperatives (WFC) provided additional information in support of the cooperatives' request on June 4 and July 31, 2002.

In the Chibardun case, the Commission noted (at p. 21 of the Chibardun Order), that the specific language in Chibardun's bylaws warranted classification of patronage capital in account 4520, Additional Paid-in Capital, because, in effect, it has been distributed, in contrast to the "undistributed balance of retained earnings" language contained in the definition of account 4550, Retained Earnings, and that Chibardun's bylaws characterize it as being furnished "for capital."<sup>5</sup>

Commission staff requested and reviewed the bylaws of the other ten cooperatives. The language concerning patronage capital in all of the cooperatives' bylaws is similar to or identical to Chibardun's language (cited in footnote 5) which was reviewed in depth in docket

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<sup>4</sup> It is not clear why this accounting change should be retroactive to December 31, 1988. There is no evident practical need for this date. It does not even coincide with the January 1, 1988, effective date of the current USOA adopted by the Commission in 1987. One possible explanation for the retroactive application of the accounting treatment is that the cooperatives seek, in effect, to indirectly "immunize" past subsidization activities that would violate Wis. Stat. § 196.204(1), particularly those activities paralleling the facts of the Chibardun order, including counting of patronage capital as retained earnings in order to increase the permissible subsidization under Wis. Stat. § 196.204(1).

<sup>5</sup> The Chibardun bylaws state in part: "All such amounts credited to the capital amount of any patron shall have the same status as though paid to the patron in cash in pursuance of a legal obligation to do so and the patron has then furnished the Cooperative corresponding amounts for capital."

1090-TI-100. However, Nelson's bylaws contain a supplemental provision similar to Chibardun's as follows:

All other amounts received by the Cooperative from non-regulated or non-operating income, ..., in excess of operating costs and expenses properly chargeable against the furnishing of such services, ..., shall insofar as permitted by law:

- 1) Be reserved as unallocated retained earnings, and shall not be allocated to the Cooperative's patrons on a patronage basis as a part of the capital credited to the accounts of patrons, as herein provided.
- 2) Be used for business purposes as determined by the Cooperative.

Although Chibardun filed a letter very much the same as all the other cooperatives on the account treatment, Commission staff notified Chibardun in a letter dated March 25, 2002, that it is bound by the Commission's Order and requested copies of journal entries evidencing compliance with the Order. A brief review of the filed 2001 cooperative annual reports shows that Chibardun is the only cooperative with a year-end balance in account 4520, Additional Paid-in Capital.

The WFC comments cite several arguments on treatment of patronage capital; they also voice concerns about inconsistent accounting between the Commission's approach and those of the Internal Revenue Service or RUS.

Documents pertinent to this discussion are available on the Commission's Web page at <http://psc.wi.gov/telecom/newsinfo/usoa/patrncap.htm>.

**NOTICE IS GIVEN** that initial and reply comments concerning appropriate accounting treatment for patronage capital by ILEC telecommunications cooperatives, including whether changes should be made to the USOA for Class A and Class B telephone utilities to adopt two new subaccounts 4550.1, Retained Earnings-Patronage Capital Unassigned, and 4550.2, Retained Earnings-Patronage Capital Assigned, and to create a new account 4511, Members Equity, and, if so, the effective date of any such changes, should be filed with the Commission. Initial comments must be received by **noon on Tuesday, October 1, 2002**, and reply comments must be received by **noon on Friday, October 11, 2002**. Comments by fax are due one day earlier. Parties should submit an original and 15 copies of their comments as indicated in the box on page 1. Fax filing cover sheets must state "Official Filing" and include the docket number and the number of pages (limit of 20 pages). File by one mode only. Comments shall provide as many specifics as possible, including detailed reasoning and suggested language, if any, for the USOA, concerning the following list to facilitate resolution of this matter.

1. Whether the Commission's patronage capital accounting directives as it concerns accounts 4520, Additional Paid-in Capital, and 4550, Retained Earnings, and its interaction with Wis. Stat. § 196.204 addressed in the Chibardun Order should be extended to all ILEC telecommunications cooperatives, or a portion thereof. If not, whether the Commission's

Chibardun Order concerning patronage capital accounting should be rescinded.

2. Whether the language in the respective ILEC telecommunications cooperative's bylaws influence in any way and, if so, to what extent, the accounting treatment to be accorded to patronage capital.
3. In what respects similarities between ILEC telecommunications cooperatives and for-profit ILECs should influence, if at all, the accounting treatment to be accorded to patronage capital.
4. What relevance Wis. Stat. ch. 185 should play in the accounting treatment to be accorded to patronage capital.
5. Whether the treatment or consideration accorded to patronage capital by other governmental agencies (e.g., RUS), via legal requirements (including court cases or other directives) or external lenders influence in any way and, if so, to what extent, the accounting treatment to be accorded to patronage capital.
6. Whether the Commission's accounting treatment of patronage capital has any impact, whatsoever, on the ILEC telecommunications cooperatives' nontaxable status for either federal or state income tax purposes.
7. Whether the Commission should adopt two new subaccounts 4550.1, Retained Earnings-Patronage Capital Unassigned, and 4550.2, Retained Earnings-Patronage Capital Assigned, and create a new account 4511, Members Equity.
8. If patronage capital-related amendments to the USOA are adopted, what should be the effective date of any such changes. If not adopted prospectively, whether any particular past date(s) should be utilized.
9. Any other comments applicable to this matter.

Subsequent to receipt and consideration of any filed comments, the Commission anticipates that it will issue an order addressing accounting treatment for patronage capital by ILEC telecommunications cooperatives, including whether changes should be made to the USOA for Class A and Class B telephone utilities.

The Commission considers it necessary, in order to carry out its duties, to investigate all books, accounts, practices, and activities of ILEC telecommunications cooperatives.

Docket 05-US-115

The Commission does not discriminate on the basis of disability in the provision of programs, services, or employment. Any person with a disability who needs accommodations to participate in this proceeding or who needs to obtain this document in a different format should contact the docket coordinator listed below. Electronic versions of various documents related to this matter have been posted on the Commission's web page at <http://psc.wi.gov/telecom/newsinfo/uso/patrnac.htm>.

Questions regarding this matter may be directed to docket coordinator Kevin H. Klingbeil at (608) 267-9504.

Dated at Madison, Wisconsin, \_\_\_\_\_

By the Commission:

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Lynda L. Dorr  
Secretary to the Commission

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